



INTRODUCTORY SECTION



State of North Carolina

Office of the State Controller

James B. Hunt, Jr.
Governor

Edward Renfrow
State Controller

The Honorable James B. Hunt, Jr.
Governor of the State of North Carolina, and

Members of the North Carolina General Assembly

It is our pleasure to furnish you with the 1998 Comprehensive Annual Financial Report (CAFR) of the State of North Carolina in compliance with G.S. 143B-426.39. This report has been prepared by the Office of the State Controller. Responsibility for both the accuracy of the data and the completeness and fairness of the presentation, including all disclosures, rests with the State government and this office. To the best of our knowledge and belief, the enclosed data are accurate in all material respects and are reported in a manner designed to present fairly the financial position and results of operations of the various funds and account groups of the State of North Carolina. We believe all disclosures necessary to enable you to gain an understanding of the State's financial activities have been included.

For the convenience of users we have divided this comprehensive annual financial report into three major sections, described as follows:

- The **introductory section** includes this transmittal letter and the State's organization chart, including a listing of principal State officials.
- The **financial section** includes the general purpose financial statements (combined statements, the notes, and the required supplementary information), the combining and individual fund and account group financial statements, and schedules.
- The **statistical section** includes selected financial, non-financial and demographic information, much of which is presented on a ten-year basis, as well as required supplementary information.

State Reporting Entity and Its Services

The State of North Carolina entity as reported in the CAFR includes all fund types and account groups of the departments, agencies, boards, commissions and authorities governed and legally controlled by the State's executive, legislative and judicial branches. In addition, the reporting entity includes legally separate component units for which the State is financially accountable. Most component units are presented discretely in the financial statements. Two component units are blended into the financial statements because their activities are so intertwined with the State that they are substantively part of the State. The State's discretely presented component units are the University of North Carolina system, the State's community colleges, and various proprietary organizations providing specific services to the public and private sector. The criteria for inclusion in the reporting entity and its presentation are defined by the Governmental Accounting Standards Board (GASB) in its GASB Codification Section 2100. These criteria are described in Note 1 of the accompanying financial statements.

The State and its component units provide a broad range of services to its citizens, including public education; higher education; health and human services; economic development; environment and natural resources; public safety, corrections, and regulation; transportation; agriculture; and general government services. The costs of these services are reflected in detail and in summary in this report.

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An Equal Opportunity/Affirmative Action/Americans With Disabilities Employer

Major Initiatives

During fiscal year 1997-98, the Governor, the General Assembly, and the departments and agencies of State government worked to address key issues facing the citizens of North Carolina.

Education

The State Board of Education developed the ABCs of Public Education in response to the School-Based Management and Accountability Program (Senate Bill 1139) enacted by the General Assembly in June 1996. The ABCs focuses on strong accountability with an emphasis on high educational standards; teaching the basics; and maximum local control. An accountability model for elementary and middle schools was implemented in 1996-97. The high school accountability model was developed during 1996-97, and was implemented for the first time in 1997-98. The ABCs Accountability Model for K-8 (elementary and middle school) and the ABCs High School Accountability Model establish growth standards for each school in the State. Schools that attain specified levels of growth are eligible for incentive awards or other recognition. Schools where growth and performance fall below specified levels are designated as low-performing.

Environment

The Clean Water Management Trust Fund approves grants across North Carolina. These projects are empowering local communities to work proactively to protect and restore water quality in the creeks and rivers of the State. The Clean Water Management Trust Fund is fulfilling the vision of the North Carolina General Assembly. In response to public concerns about water quality problems across the state, the Legislature established the Clean Water Management Trust Fund in 1996 to assist in financing projects to protect or restore water quality in the rivers, creeks, lakes, and estuaries of North Carolina.

On November 3, 1998, North Carolina voters approved \$800 million of new debt to finance grants and loans to local government units for water supply systems, wastewater collection systems, wastewater treatment works, and water conservation and water reuse projects.

Tax Relief

Effective January 1, 1999, the State will repeal the inheritance tax and levy an estate tax equal to the Federal state death tax credit. The net affect of this legislation will be a decrease in tax revenues of an estimated \$310.2 million through fiscal year 2002-03. Effective May 1, 1999, the State will repeal the sales tax on food. This is estimated to cost the State \$790.2 million through fiscal year 2002-03. The repeal of income tax (*result of Bailey Case, see Note 18*) on the pension income of retired government employees is estimated to cost the State \$128.6 million in fiscal year 1998-99 and thereafter.

Social Programs

The Department of Health and Human Services works in local offices, schools and hospitals, building a stronger North Carolina. Examples of the Department of Health and Human Services at work include: social workers finding families for children who need foster care or adoption; case workers helping people find their way to self-sufficiency; child support agents tracking down deadbeat parents and making them take responsibility for their children and for paying child support; rehabilitation specialists helping the disabled learn everyday skills so they can live life to the fullest; counselors motivating troubled youth and helping them avoid a life of crime; health professionals bringing services to families without access to health care in rural and urban communities; advisors helping families understand their options for home-based and community care for older relatives; public health nurses immunizing children to protect them from disease; teachers educating children who are deaf or blind to prepare them for the working world; licensing specialists overseeing the safety and proper management of child care centers, emergency medical services, hospitals, nursing homes or other health facilities.

Crime

Throughout the State and nation, overall crime rates remain high. Younger offenders are committing more serious crimes. The juvenile population of North Carolina is expected to grow faster than the general population and additional efforts will be required to enhance prevention and promote more effective punishment among our adolescent population. Additional emphasis will be placed on the problem of youth access to drugs, alcohol and tobacco. Crime is on the increase in rural areas as drug dealers expand their operations from cities to the country. Prevention and enforcement programs involving more than one State agency can provide help to local law officers in problem areas. The State is shifting its philosophy of public safety to a more comprehensive, community-based approach and problem-oriented crime prevention. The demand from both the public and the private sectors for relevant, accurate and timely criminal justice information will continue to grow. Through initiatives like the Criminal Justice Information Network (CJIN), the State has an opportunity to use technology to maximize existing resources.

Economic Development

On July 23, 1998, Governor Hunt signed the Economic Opportunity Act of 1998. The law is designed to promote economic development throughout the State. It allows various credits and tax reductions for certain recycling facilities and allows various sales tax and property tax exemptions for air couriers. The new Economic Opportunity Act also provides for the designation of economically distressed areas located within municipalities as State Development Zones. It further authorizes enhanced incentives for businesses that locate in a development zone. In addition, the Industrial Development Fund has been enhanced to provide additional funds or to expand the availability of funds that can be used for equipment, capital improvements and utility distribution lines. The Fund also provides financial assistance to local government units of the most economically distressed counties in the State. To encourage the development of air courier hubs in North Carolina, the bill provides a reduction in the state's sales tax and property tax for interstate air couriers. Beginning with the 2001 property tax year, the bill provides a property tax exemption for aircraft owned by an air courier and apportioned for property tax purposes to the courier's hub in North Carolina.

On November 3, 1998, the North Carolina voters approved \$200 million of new debt to finance grants, loans, or other financing to public or private entities for construction of natural gas facilities.

Year 2000

The Year 2000 issue is the result of shortcomings in many electronic data processing systems and other equipment that make operations beyond the year 1999 troublesome. For many years, programmers eliminated the first two digits from a year when writing programs. Unfortunately, many programs (if not corrected) will not be able to distinguish between the Year 2000 and the year 1900. This may cause the programs to process data inaccurately or to stop processing data altogether. All information systems in North Carolina that use dates to generate data will be affected by the new millennium: for example, kindergarten registration and blood supply could be affected. In addition, non-information systems such as forms need to be evaluated because they provide input to software applications. Mail processing equipment may need to be modified to handle the new millennium. Other areas such as elevators, security systems, and vaults will be affected by the Year 2000.

In early 1997, the Year 2000 Project Team (including a statewide Steering Committee and agency coordinators) was formed to manage the Year 2000 project from a statewide perspective. The Year 2000 Project Team is responsible for prioritizing systems statewide, developing and maintaining statewide conversion schedules, analyzing third-party product compliance, maintaining a statewide Year 2000 repository, defining the overall conversion approach and milestones, reporting the status of statewide conversion projects, providing statewide communications and coordination, reporting the status of statewide Year 2000 funding and use, reporting the status of statewide quality assurance, developing and maintaining a statewide risk

management plan, coordinating the Year 2000 budget process, maintaining an evolving cost estimate, and analyzing the automated tool offerings.

Economic Condition and Outlook

Condition

For the seventh straight year, both the national and North Carolina economies grew in 1998. At the national level, Gross Domestic Product, the broadest measure of economic activity, grew an estimated 3.2% during the year. Over three million jobs were added, and the national unemployment rate fell to a twenty-eight year low of 4.5%. The pace of economic activity in North Carolina exceeded that for the nation. Gross State Product, a measure of economic output in the State, rose by over 5% in 1998. The State's job market also improved, with over 40,000 net new jobs added to the labor force. The State's unemployment rate fell to 3.5%, and in the State's metropolitan areas, unemployment dropped to under 2.5%.

Economic growth in North Carolina was widespread across most economic sectors. One exception was the textile and apparel sector, where 11,000 jobs were cut in 1998. Inflation and interest rates were helpful to the economy in 1998. As the year ended, the annual inflation rate at the retail level was running under 2%, less than 1997's rate. Both long and short-term interest rates also fell over one percentage point during the year. The improved interest rate situation was helped by a turnaround in federal fiscal affairs. For the first time in twenty-nine years, the unified federal budget ran a surplus. Growth in federal revenues (over 7% annually) exceeding growth in federal spending (3% annually) was the major reason for the surplus. The surplus reduced the need for borrowing by the federal government and reduced the pressure on interest rates.

Outlook

Despite this rosy economic news, clouds formed over the economy in 1998. Financial problems in several foreign countries, including Japan, contributed to sharp declines in the U.S. stock market. Thus, as 1998 came to a close, more and more decision-makers were questioning whether the long economic expansion was about to be overtaken by a recession. There are two major issues facing today's economy. One is the financial and economic decline in several foreign countries, including Japan, Russia, South Korea, Indonesia, and Brazil. These countries are in recession and their stock markets have tumbled. The concern is that these economic problems will spread to the United States and North Carolina.

Although the decline of foreign economies can adversely affect the U.S. through reduced export sales and failed investments, these impacts can be overstated. U.S. exports to the troubled foreign economies account for less than 3% of total U.S. income, and U.S. bank investments in the same countries are also less than 3% of total bank assets. These percentages are even smaller for North Carolina. Therefore, it is unlikely that the current foreign economic troubles will send the United States and North Carolina economies into tailspins. The other major economic issue is the prospect for faster rising labor costs. Due to the tight labor market, labor costs have been rising at faster rates for several years. For example, labor costs rose an estimated 3.5% in 1998, up from 3.1% in 1997 and 2.8% in 1996. Thus far, improved labor productivity has offset the additional labor costs. But many economists think this fortunate circumstance will not continue.

If businesses are faced with higher labor costs and are not compensated by improved labor productivity, then three outcomes are possible. Business can pass on the higher costs in the form of higher prices, thereby generating higher general inflation. Or, business can reduce labor costs by dismissing workers. The third possibility is that businesses can absorb the higher labor costs and reduce profits. All three possibilities are not good for the economy. Each would cause the economy to grow at a slower rate. The outlook is that the economy will indeed grow more slowly in 1999. Nationally, Gross Domestic Product will grow 2.5%, and no net new jobs will be added to the national payrolls. In North Carolina, Gross State Product will increase 3.5%, and job growth will be 1.5 %, down from 1998's 2% growth rate.

As the economy slows in 1999, businesses making durable goods, like manufacturing and construction, will be the most adversely affected. For example, job growth in North Carolina's manufacturing sector is expected to be only 0.6% in 1999. The real (inflation-adjusted) value of residential construction in the State rose 14% in 1998, but is forecasted to rise only 5.5% in 1999. Pushed by faster climbing labor costs, the inflation rate is projected to rise to between 2% and 2.5% in 1999, up from 1998's rate of 1.6%. Interest rates will either change little or edge up slightly.

In conclusion, an economic slowdown is forecasted for the nation and for North Carolina in 1999. An economic slowdown is not a recession. A recession means the economy actually shrinks; a slowdown means the economy continues to grow, albeit at a slower pace. North Carolina's economy will move forward in 1999, but at a walk, not a trot!

— *Economic analysis prepared by Dr. Michael L. Walden, Professor
North Carolina State University
November 2, 1998*

Financial Information

Internal Control

Management of the government is responsible for establishing and maintaining an internal control structure designed to ensure that the assets of the State are protected from loss, theft or misuse and to ensure that adequate accounting data are compiled to allow for the preparation of financial statements in conformity with generally accepted accounting principles. The internal control structure is designed to provide reasonable, but not absolute, assurance that these objectives are met. The concept of reasonable assurance recognizes that: (1) the cost of a control should not exceed the benefits likely to be derived, and (2) the valuation of costs and benefits requires estimates and judgments by management.

As a recipient of federal financial assistance, the State also is responsible for ensuring that an adequate internal control structure is in place to ensure compliance with applicable laws and regulations related to those programs. This internal control structure is subject to periodic evaluation by management, internal audit staff, and independent auditors of the government.

Budgetary Control

In addition, the State maintains budgetary controls. The objective of these budgetary controls is to ensure compliance with legal provisions embodied in the annual appropriated budget approved by the General Assembly. Activities of the General Fund and most departmental special revenue funds are included in the annual appropriated budget. The State Highway Fund and the Highway Trust Fund, the State's major special revenue funds, are primarily budgeted on a multi-year basis. Capital projects are funded and planned in accordance with the time it will take to complete the project. The level of budgetary control (that is, the level at which expenditures cannot legally exceed the appropriated amount) is exercised at both the departmental and university level by way of quarterly allotments, with allotment control exercised by the State Controller, and on the program line-item levels requiring certain approvals by the Director of the Budget. Legislative authorization of departmental expenditures appears in the State Appropriation Bill. This "Certified Budget" is the legal expenditure authority; however, executive changes to the legal budget may be approved by the Office of State Budget and Management (OSBM). This results in the "Final Budget" presented in the financial statements.

GAAP Accounting

Although the State budgets and manages its financial affairs on the cash basis of accounting, G.S. 143-20.1 requires the Office of the State Controller to prepare a comprehensive annual financial report (CAFR) in accordance with generally accepted accounting principles (GAAP). Furthermore, the Governmental Accounting Standards Board and the nation's financial community have encouraged states to present, in their annual reports, financial statements of the

governmental funds that are prepared on the modified accrual basis of accounting, following generally accepted accounting principles. Under this basis, which more adequately serves the financial community's analytical and other needs, revenues are recognized when they become both measurable and available to finance operations of the fiscal year, or to liquidate liabilities existing at fiscal year-end. Generally, expenditures are recognized when a liability is incurred. Except for exhibits and notes clearly labeled otherwise, this CAFR has been prepared in accordance with GAAP.

Results of Operations

General Governmental Funds

Revenues and Other Financing Sources

Revenues and other financing sources for general governmental functions (General Fund, special revenue funds, and capital projects funds) amounted to \$23.4 billion for the fiscal year ended June 30, 1998, using the modified accrual basis of accounting. The major categories of revenues and other financing sources are shown in the following table. Amounts are expressed in millions.

	Amount	Percent of Total
Revenues:		
Taxes.....	\$ 13,288	56.8%
Federal funds.....	5,983	25.6%
Local funds.....	463	2.0%
Investment earnings.....	576	2.5%
Fees, licenses and fines.....	826	3.5%
Other.....	326	1.4%
Total revenues.....	<u>21,462</u>	91.8%
Other Financing Sources:		
Operating transfers in and other sources.....	1,232	5.3%
Proceeds from bond sale.....	700	2.9%
Total other financing sources.....	<u>1,932</u>	8.2%
Total Revenues and Other Financing Sources.....	<u>\$ 23,394</u>	100.0%

Tax Revenues. Tax revenues increased by \$1.1 billion in 1998, reflecting a continuing favorable economic climate in North Carolina. Income tax collections increased by \$800.2 million in 1998 to \$7.1 billion, a 12.7% increase over 1997. Sales tax collections grew by \$138 million in 1998, a 4.4% increase over 1997. Highway taxes were \$1.477 billion in 1998, \$89.9 million more than in 1997.

Federal Funds. Federal funds revenues grew by \$125 million in 1998, up by 2.1% over 1997. Increases in Federal revenues are due to increased Federal program expenditures for which the State is reimbursed.

Expenditures and Other Financing Uses

Investment Earnings. Investment earnings reflect an increase of \$121 million in 1998. Several factors contributed to this increase. In fiscal year 1998, the State implemented GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*, which resulted in fair value accounting for investments, and an investment earnings increase of \$7 million. Securities lending activity resulted in an increase of \$40 million, while interest earnings on bond proceeds accounted for \$51 million of the investment earnings increase. General growth in investment earnings accounts for the remaining increase of \$23 million. The growth in 1998 can be directly attributed to the favorable investment climate through June 30, 1998, and the investment management strategies of the State Treasurer.

Expenditures and other financing uses for general governmental purposes totaled \$22.9 billion in 1998, using the modified accrual basis of accounting. The major categories of expenditures and other financing uses, by function, are shown in the following table. Amounts are expressed in millions.

	Amount	Percent of Total
Expenditures:		
Current:		
General government.....	\$ 1,116	4.9%
Education.....	5,416	23.7%
Health and human services.....	7,300	31.9%
Economic development.....	322	1.4%
Environment and natural resources.....	333	1.5%
Public safety, corrections, and regulation.....	1,579	6.9%
Transportation.....	2,384	10.4%
Agriculture.....	69	0.3%
Retiree tax judgments.....	400	1.7%
Capital outlay.....	204	0.9%
Debt service.....	170	0.7%
Total expenditures.....	19,293	84.3%
Other Financing Uses:		
Operating transfers out.....	1,218	5.3%
Operating transfers to component units.....	2,374	10.4%
Total other financing uses.....	3,592	15.7%
Total Expenditures and Other Financing Uses.....	\$ 22,885	100.0%

Significant changes in expenditures. The trend of increases in expenditures, an increase of \$1.6 billion for 1998, was directly related to the continued emphasis on education, health and human services, and transportation. A large portion of the increase in governmental expenditures, *retiree tax judgments*, is the result of the North Carolina Supreme Court ruling in the Bailey case (**Note 18**). On June 9, 1998, representatives of the State and the various retirees involved in the Bailey and Patton cases announced a settlement, which was later approved by the court, in the amount of \$799 million. Of this amount, \$400 million will be disbursed in refunds in fiscal year 1998-99, and \$399 million will be paid in refunds during fiscal year 1999-2000. Educational expenditures increased by \$640 million largely because of growth in dollars spent on State administered programs and the increasing costs associated with providing public education. Health and human services increased by \$477 million in 1998 (\$143 million when adjusted for reorganization), with this increase largely attributable to the reorganization of the State's public health resources. An offsetting decrease in expenditures of \$335 million occurred in expenditures for environment and natural resources. There was a decrease in spending for 1998 for public safety, corrections, and regulation of \$35 million. This decrease compared to 1997 is the result of decreased emergency assistance payments (hurricane relief) through June 30, 1998. Transportation expenditures increased in fiscal year 1998 by \$179 million. Debt service will continue to climb, a \$39 million increase from 1997 to 1998, as the State continues to issue general obligation debt to fund capital projects for education, highways and utilities.

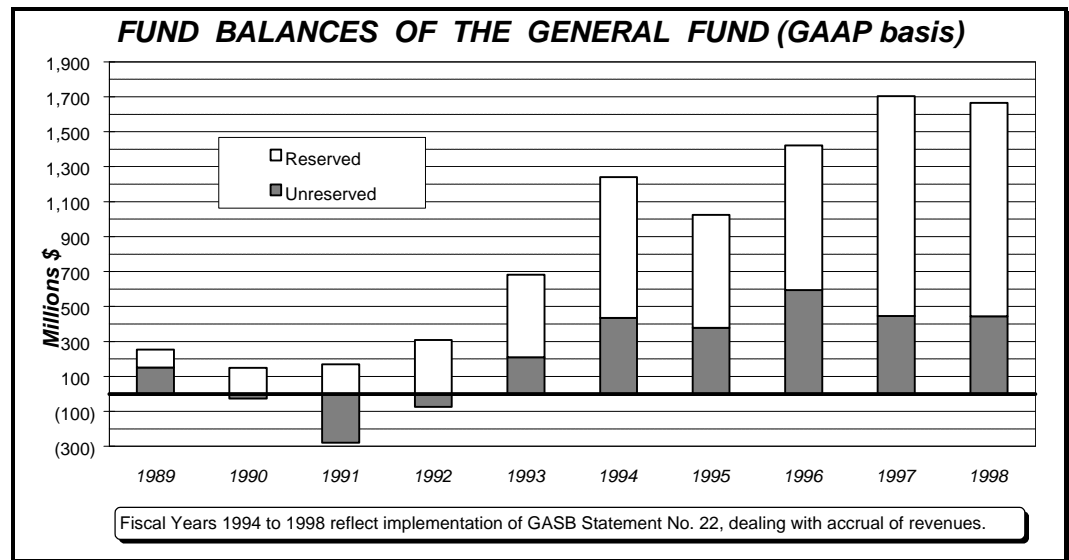
Additional information, in greater detail and for the past ten years, may be examined in the statistical section.

GAAP Fund Balance

General Fund

The fund balance of the General Fund declined by \$39 million in 1998. Although the growth in tax and other revenues once again exceeded expectations this year, which directly contributed to the strong condition of the General Fund at year end, expenditures and transfers out exceeded revenues and transfers in by \$33.8 million. At June 30, 1998 the fund balance of the General Fund on the modified accrual basis was \$1.665 billion, in comparison to a \$1.704 billion balance at the end of 1997.

The following chart illustrates the fund balances on the modified accrual (GAAP) basis of the General Fund for the last ten fiscal years.



Savings Reserve

During the 1991 session, the General Assembly established a Savings Reserve Account as a restricted reserved portion of fund balance in the General Fund, becoming effective for the year ended June 30, 1992. Under this legislation, one-fourth of any unreserved credit balance (defined by the General Statutes as "...the credit balance, as determined on a cash basis, not already reserved to the Savings Reserve Account.") remaining in the General Fund at the end of each fiscal year will be transferred to the Savings Reserve until the account contains funds equal to 5% of the amount appropriated to the General Fund operating budget for the preceding year. On June 30, 1998, \$21.6 million was transferred into the Savings Reserve Account, bringing the total reserve to the 5% cap of \$522.5 million.

Summary of Savings Reserve Account (in millions) :			Increase/ (Decrease)	Balance
Date		Description		
		Reserve - Budget Stabilization (Rainy Day Fund)	\$ 0.4	\$ 0.4
June	1992	Statutory Reservation - G. S. 143-15.3	41.2	41.6
June	1993	Statutory Reservation - G. S. 143-15.3	134.3	175.9
July	1993	Withdrawal from Reserve	(121.0)	54.9
June	1994	Statutory Reservation - G. S. 143-15.3	155.7	210.6
January	1995	Budget Stabilization Appropriation	66.7	277.3
June	1995	Statutory Reservation - G. S. 143-15.3	146.3	423.6
June	1996	Statutory Reservation - G. S. 143-15.3	77.3	500.9
June	1997	Statutory Reservation - G. S. 143-15.3	—	500.9
June	1998	Statutory Reservation - G. S. 143-15.3	21.6	\$ 522.5

Repairs and Renovations Reserve

The 1993 General Assembly, in an effort to provide for the State's capital needs, established the Repairs and Renovations Reserve Account (G.S. 143-15.3A). Repairs and Renovations Reserve Account is defined to consist of 3.0% of the replacement value of all State buildings supported by the General Fund, at the end of each fiscal year. The funds in the Repairs

and Renovations Reserve Account are to be used only for the repair and renovation of State buildings and related infrastructure that are supported by the General Fund. For fiscal year 1997-98, the General Assembly placed \$145 million into this reserve. The balance in the Repairs and Renovations Reserve at June 30, 1998 was \$174.2 million.

Clean Water Management Trust Fund

For fiscal year 1995-96, the General Assembly established the Clean Water Management Trust Fund to finance projects to clean up or prevent surface water pollution (G.S. 113-145.3). The amount reserved in the General Fund each year is defined as 6.5% of any unreserved credit balance remaining in the General Fund at the end of the fiscal year or \$30 million, whichever is greater. For the 1997-98 fiscal year, \$47.4 million was placed in this reserve.

North Carolina Railroad Acquisition

For fiscal year 1996-97, the General Assembly established the Railroad Reserve Account. In order to help promote trade, industry, and transportation within the State of North Carolina and to advance the economic interests of the State and its citizens, the General Assembly determined it to be advantageous for the State to acquire the outstanding shares of the North Carolina Railroad Company not held by the State. At June 30, 1997, the amount of \$61 million of the unreserved General Fund balance was placed in the Railroad Reserve Account. On April 1, 1998 the General Fund loaned the North Carolina Railroad Company \$61 million for the retirement of non-State owned common stock shares of the Railroad. The \$61 million will remain in reserve until the related debt is satisfied. At June 30, 1998, the balance in the reserve was \$61 million.

DPI Allocation

For the fiscal year 1997-98, the General Assembly reserved \$55 million of unexpended General Fund appropriations to be used by the Department of Public Instruction (DPI) to fund public school employee performance bonuses, longevity payments, school bus purchases, and the purchase of additional school technology.

Disproportionate Share

Disproportionate share payments are Medicaid payments made to hospitals which serve a disproportionate share of indigent patients. This account was established to reserve for future appropriation any excess collection of disproportionate share revenues above those budgeted as departmental receipts or non-tax revenues. There was \$35.4 million in this reserve at June 30, 1998.

Work First

For the fiscal year 1997-98, the General Assembly established the Work First Reserve Fund. At the end of each fiscal year, the State Controller shall reserve State funds in an amount equaling one-fourth of any Work First Program funds from General Fund appropriations remaining unexpended at the end of the fiscal year, up to a maximum balance in the account of \$50 million. The General Assembly may appropriate additional funds into this reserve. The balance in this reserve at June 30, 1998 was \$19.5 million.

Other Funds

Proprietary Funds

Operating revenues and operating expenses for the State's enterprise funds were \$23.7 million and \$26.8 million, respectively, in 1998. Operating loss was \$3.1 million.

Combined operating results for the State's internal service funds exhibited continued strength in 1998. Operating revenues and expenses for these cost-reimbursement funds totaled \$1.004 billion and \$998 million, respectively, in 1998. Principal internal service fund operations include the State Health Plan, the Disability Income Plan, the Death Benefit Plan, Prison

Enterprises, the State Property Fire Insurance, Motor Fleet Management, Centralized Computing Services, and State Telecommunications.

Pension Trust Funds

The operations of the Teachers' and State Employees' Retirement System continued its steady growth in 1998. The system's contributions increased by .6%. The system experienced a 10.4% increase in benefit payments to participants. For the fiscal year ended June 30, 1998, the State continued to fund the actuarial required contribution. The State also participates in the Consolidated Judicial Retirement System, the Legislative Retirement System, the Firemen's and Rescue Squad Workers' Pension Fund and the North Carolina National Guard Pension Fund. The Local Governmental Employees' Retirement System is administered by the State but the State is not a participant. Each of these systems continued to show a positive trend in funding.

Debt Administration

At June 30, 1998, the State had a number of debt issues outstanding. These issues included \$2.1 billion in general obligation bonds, \$1.3 billion in revenue bonds in the component unit proprietary funds and \$839 million in revenue bonds in the university funds. North Carolina continues to have AAA bond ratings issued by Standard and Poor's Corporation and Moody's Investors Service, the highest ratings attainable. These favorable ratings have enabled the State to sell its bonds at interest rates considerably below the Bond Buyer's Index, thereby providing substantial savings to North Carolina taxpayers. North Carolina is one of only a very small number of states currently having the AAA ratings. In addition, approximately 25 percent of all AAA ratings for state and local governments nationwide are located in North Carolina.

Cash Management

It is the policy of the State that all agencies, institutions, departments, bureaus, boards, commissions and officers of the State shall devise techniques and procedures for the receipt, deposit and disbursement of monies coming into their control and custody which are designed to maximize interest-bearing investment of cash, and to minimize idle and nonproductive cash balances. The State Controller, with the advice and assistance of the State Treasurer, the State Budget Officer, and the State Auditor, develops, implements, and amends the *Statewide Cash Management Policy*. All cash deposited with the State Treasurer by State entities is managed in pooled investment accounts to maximize interest earnings. During fiscal year 1998, uncommitted State funds were invested in short-term and medium-term U.S. Government notes and bonds, as well as other deposits, which had a composite average yield of 6.394%.

Risk Management

The State has a limited risk management program for fire and other property losses. As part of this comprehensive plan, resources are being accumulated in an internal service fund to meet potential losses. See **Note 12** of the Notes to the Financial Statements for a full description of the State's risk management program.

Other Information

Independent Audit

In compliance with State statute, an annual financial audit of the State entity is completed each year by the North Carolina Office of the State Auditor. The Auditor's examination was conducted in accordance with generally accepted government auditing standards and his opinion has been included in this report. In addition, the State coordinates the "Single Audit" effort of all federal funds through the State Auditor.

Certificate of Achievement

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the State of North Carolina for its comprehensive annual financial report (CAFR) for the fiscal year ended June 30, 1997. The Certificate of Achievement is a prestigious national award recognizing conformance with the highest standards for preparation of state and local government financial reports.

In order to be awarded a Certificate of Achievement, a government unit must publish an easily readable and efficiently organized comprehensive annual financial report, whose contents conform to program standards. The CAFR must satisfy both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. We believe our current report continues to conform to the Certificate of Achievement program requirements, and we are submitting it to GFOA.

Acknowledgments

In conclusion, we believe this report provides useful data to all parties using it in evaluating the financial activity of the State of North Carolina. We in the Office of the State Controller express our appreciation to the financial officers throughout State government and to the Office of the State Auditor for their dedicated efforts in assisting us in the preparation of this report. Any questions concerning the information contained in this Comprehensive Annual Financial Report should be directed to the Office of the State Controller at (919)981-5454.

Respectfully submitted,

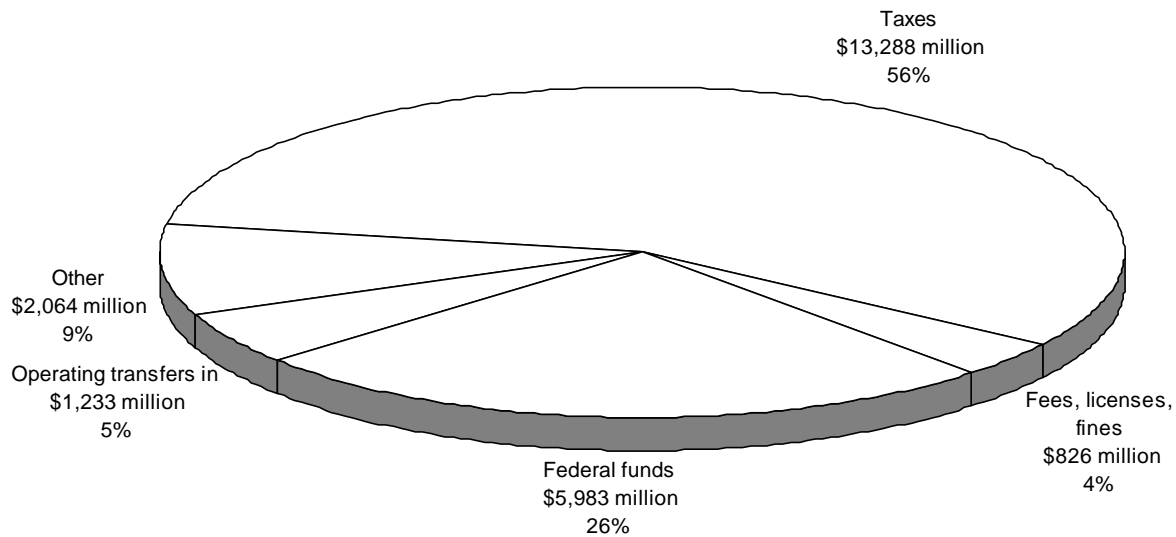
A handwritten signature in black ink, appearing to read "Edward Renfrow", written in a cursive style.

Edward Renfrow
State Controller

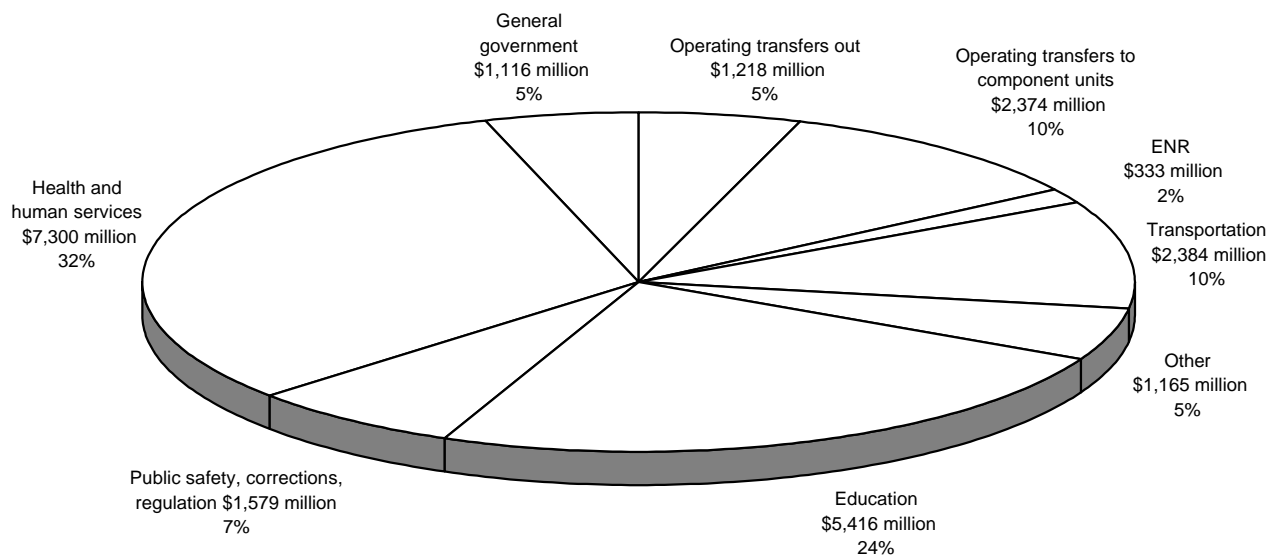
December 4, 1998

General Governmental
General, Special Revenue, and Capital Projects Funds
For the Fiscal Year Ended June 30, 1998

Revenues and Other Financing Sources
\$23.394 billion



Expenditures and Other Financing Uses
\$22.885 billion



CERTIFICATE OF ACHIEVEMENT

Certificate of Achievement for Excellence in Financial Reporting

Presented to

State of
North Carolina

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
June 30, 1997

A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.



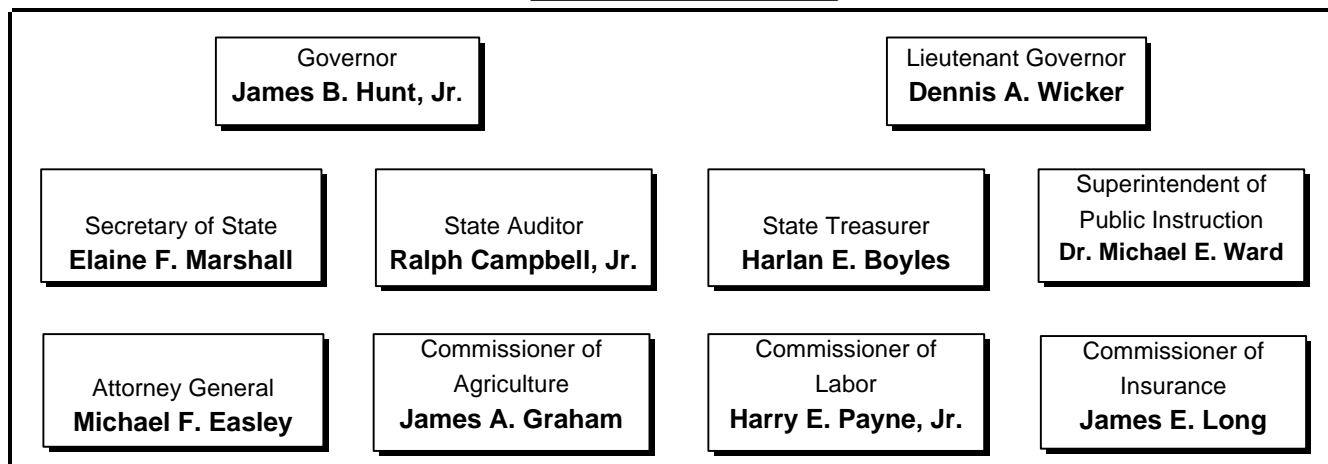
Douglas R. Ellsworth
President

Jeffrey L. Esser
Executive Director

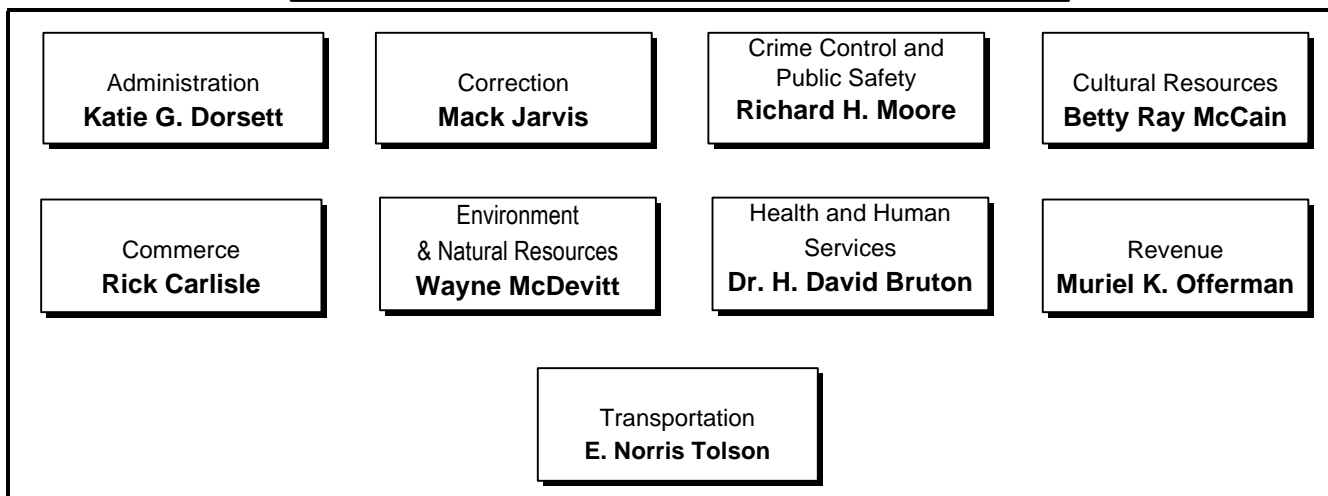
ORGANIZATION OF NORTH CAROLINA STATE GOVERNMENT INCLUDING PRINCIPAL STATE OFFICIALS

EXECUTIVE BRANCH

Council of State



Cabinet Secretaries — Appointed by the Governor



Appointed by Governor, confirmed by Legislature

Office of the
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Edward Renfrow
State Controller

State Board
of Education
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Chairman

Appointed by State Board of Community Colleges

H. Martin Lancaster
President

Appointed by University Board of Governors

Molly C. Broad
President

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President
Lieutenant Governor

President Pro Tempore
Marc Basnight

Deputy Pres. Pro Tempore
R. C. Soles, Jr.

Majority Leader
J. Richard Conder

Minority Leader
Betsy L. Cochrane

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Representatives**

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Harold J. Brubaker

Speaker Pro Tempore
Carolyn B. Russell

Majority Leader
N. Leo Daughtry

Minority Leader
James B. Black

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Supreme Court**

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Burley B. Mitchell, Jr.

Associate Justices
Henry E. Frye
I. Beverly Lake, Jr.
Robert F. Orr
Sarah Parker
John Webb
Willis P. Whichard

Administrative
Office of the Courts
Dallas A. Cameron, Jr.
Director

Component Units**University of North Carolina System****Community
Colleges****Proprietary
Funds**

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